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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE New Year has begun quietly so far as the markets and new business activity are concerned. Industries have not been selling as much as they have been shipping, and therefore have been cutting into their backlogs of unfilled orders, in some cases at a fairly rapid rate. Where orders on hand have declined to any great extent operating schedules have been reduced. However, curtailment is by no means general. Most industries have had sufficient backlogs to sustain operations through January, and go into February with a substantial though declining volume of orders still on the books. Machinery and equipment industries particularly are still running strong. They have enough business to keep them going for periods ranging from two or three months until some time in 1941, with the airplane manufacturers, shipbuilders, and machine tool companies sold farthest ahead.

The most pronounced drop in operations has been in the steel mills, where the rate declined from the high of 94.4 per cent of capacity at the beginning of December to 77.3 in the last week of January. For several weeks in 1939 the mills turned out the highest weekly tonnage of steel ever produced. Readjustment of this rate to one more in line with consumption had been generally foreseen, but the decline both in orders and operations has been sharper than expected. The trade reviews have estimated new orders during the month at around 50 per cent of capacity.

Textile mills have maintained operations, with scattered exceptions, but many are beginning to need new orders. In automobile output slackening thus far has been nominal. With retail sales running substantially ahead of a year ago, it has taken longer than usual to build up dealers' stocks this season. Some tapering off in the period before Spring demand opens up is in prospect, but even then automobile production is expected to give good support to business.

The construction industry is off to none too good a start in comparison with 1939, for contract awards in the first three weeks of January were 21 per cent lower,—due entirely, however, to the decline in public work. Mortgage applications selected for appraisal by the Federal Housing Administration, to finance new construction, have run slightly behind a year earlier. Of course conclusions cannot be drawn from a few weeks' figures.

Commodity Markets Sluggish

In commodity markets business has been sluggish. Manufacturers are still covered on materials, from their purchases last Fall; and the speculative interest which developed in cotton, silk, wheat and a few other staples in December has been followed by liquidation, with the result that prices, on the average, have lost their December gains. These speculative movements originated in India, Japan and other foreign markets and were chiefly confined to those markets. The rise was spectacular, and the reaction has been equally so, with cotton in Bombay down nearly 3 cents and silk in Yokohama off more than $1.50 a pound; but except for the troubles of the silk hosiery manufacturers neither the rise nor the fall has had much effect here.

Some farm prices have advanced during January, for seasonal reasons, but the gains have been absorbed by losses elsewhere. The non-ferrous metals, which are among the prices most sensitive to the industrial situation, have weakened, and curtailment of copper production can be expected unless demand soon revives.

Probably the easing of commodity prices is disappointing to many people who allowed their expectations to rise in December, and who would welcome a renewal of the price advance, if not overdone, for the sake of its influence on business. The lesson of history is that wars raise prices, and whenever markets strengthen for a time there are anxious questions as to whether the long-discussed inflationary movement has in fact begun. The current reaction, however, demonstrates that prudence and conservative judgment are in

order. One lesson is that false starts will occur; another, that the wartime psychology may overemphasize the influences increasing consumption and underestimate the ability to supply the demand. Such miscalculations lay the ground for disappointment.

The eventual effects of this war upon commodity prices are hard to foretell. Time is required for its influences to work themselves out, and no one knows whether an analogy can be drawn from the last war, when no material price improvement occurred for more than a year, only to be followed by the spectacular 1916-20 inflation. So far this war has not greatly altered the relative production and consumption of basic commodities, with a few conspicuous exceptions. It stimulated prices at the beginning, but chiefly through the psychological effects and through shipping and insurance costs; and for the time being the war has dropped back to second place as a market influence, subordinate to domestic conditions.

Reasons for Business Quieting Down

Business men generally agree in their interpretation of the domestic situation. The almost unprecedented concentration of buying within two or three months last Fall covered requirements well ahead, and the commitments made provided not only for increased consumption but for replenishment of inventories, in line with higher sales. The effect was to raise production above the consumption level. As soon as the proportions of the upswing became clear experienced business leaders warned of the letdown to follow. These warnings have served a constructive purpose. They modified some of the over-optimistic ideas as to the probable volume of war business and expansion of export trade, and they had a good deal to do with dispelling fears of scarcity of commodities.

The slackening in new buying in the last few weeks may be ascribed both to satisfied requirements, and to a better-considered view of the prospect for the early part of 1940. Buyers cannot indefinitely stay out of the markets. As the season advances new requirements will have to be filled, and there is considerable evidence of intention to keep well-covered while the war lasts. Sentiment has been prepared, however, for curtailment in industrial operations.

In the composite indexes which measure industrial output a drop at this time of year is accentuated by the fact that it is contrary to the usual seasonal trend. For this reason alone the Federal Reserve Board's adjusted index of industrial production, which made a new all-time record in December at 128 (1923-25 = 100), would decline from December through March or April, even if production were maintained. Thus a drop in output, in conjunction with this seasonal adjustment, may bring the index down fairly rapidly. This index has been widely used and published in the past few years, and the fact that under present conditions it may exaggerate a reaction should be understood.

A good level of retail distribution is one of the strong points in business. Department store sales improved after Christmas, when cold weather provided a stimulus, and for the whole month of December dollar sales (seasonally adjusted) were higher than in any month of 1936-37, although prices are lower. The improvement carried over into January but slackened toward the end of the month, due partly to stormy weather. The mail order houses have continued to make exceptional records.

Stocks of merchandise in retailers' hands have risen somewhat since Summer. But nothing like the 1937 over-expansion of inventory and commitments has occurred, according to available figures. The number of buyers in the wholesale markets in January and attending the openings of Spring lines has exceeded or equalled past records. Business has been fair, but the general disposition is conservative.

Supporting Elements

Whether the business situation is to be considered disappointing or not depends upon the viewpoint. Compared with the last quarter of 1939 the trend is downward. Compared with a year ago, and with the other years of the depression except 1936 and 1937, it is safe to assume that business activity through the first quarter will be larger, employment greater, and earnings for the most part higher.

Accepting the reduction of recent high operating rates in some industries as necessary, if the markets are not to be over-loaded with goods, the earlier the curtailment comes the less severe it should be, and the better will be the future prospect. There would be more reason for alarm if the steel industry had continued to operate at 90 per cent of capacity, with requirements for steel around 65 or 70 per cent, than there is now.

The possibility that the recession will feed upon itself, with production, consumption and prices all interacting, is diminished by the conservatism that has prevailed since the early bullish outburst. The movement of business during the last four months of 1939, so far as new orders and production were concerned, had the aspects of a great boom, but in some respects it was remarkably free of boom symptoms. The rise in both security and commodity prices stopped within a short time, and was moderate while it lasted. The price reaction since the demand slackened has been slight. Wage rates have not been widely increased and major labor disturbances have not arisen, except in the Chrysler strike. No fresh body of debt of any magnitude has been created, and monetary influences are favorable.

Major depressions of the past have been ushered in by excessive commodity and secur-

ity speculation, excessive debt-making, and by increases in industrial costs and prices, resulting either from wage increases greater than could be absorbed by increased efficiency, or from actual declines in productivity. These dangers to a great extent have been kept out of the upswing, and it is to the credit of all elements concerned that this is so.

Finally, the supporting influence of the war, both in maintaining prices and in development of export trade, over the long run may be more considerable than now seems to be believed. It has taken time to build up the Allied buying organization, and it takes time to perfect its program and to complete contracts and get production flowing on many of the things needed.

The inventory situation is receiving much attention, and as usual the lack of representative and up to date reports is a handicap. However, the opinion may be offered that inventories are not the most important element in the situation. The evidence is that they are not excessive in relation to present consumption and will not reach threatening proportions unless consumption falls off considerably. Although inventory ups and downs may cause minor swings in business, and contribute to all business fluctuations, it is usually a mistake to try to explain major changes in the business situation chiefly in terms of inventories. The important question is whether influences are present which keep goods from moving, cause stocks to mount, and prevent production from being absorbed.

New Financing Slack

Two questions remain, both asked repeatedly since the depression began, and both receiving the same answer. Why is this upswing, like every other since 1929, stopping at a time when there are still millions of unemployed who want work, and when the only natural limit upon business, i.e., the limit of capacity to produce, is far from reached? After a rise in industrial operations has lifted production above consumption, why is it assumed, almost without question, that the balance must be re-established chiefly by curtailment of production instead of by a rise in consumption?

These questions open up problems almost incomprehensibly complex, if pursued to the end. Nevertheless the immediate answer is plain, and is one upon which most economists, of all schools of thought, agree. What is needed to convert the improvement into recovery is a greater flow of savings into durable goods and new investment, more new ventures, and more vigorous new enterprise. When the war broke out, the sudden rush of demands upon the industries stimulated capital expenditure in the same pronounced fashion that it stimulated demand for consumer goods. As sales jumped and delivery periods lengthened, business men who had projects for new plant or equipment in hand were encouraged to carry them out, and the upswing stimulated the formulation of new programs.

The outstanding difference between this increase in capital expenditure and all similar movements of the past is that it has produced no expansion of security offerings to raise new capital. Purchases of machinery and equipment were financed for the most part out of accumulated earnings and depreciation accounts. The following table gives the total of new money raised in the public markets during the past five years and in 1929, showing the stagnation that prevailed during the last quarter, although business was more active than since 1929. Even the 1936 and 1937 figures were huge by comparison. It should be noted that the figures include only public issues. It is estimated that in both 1938 and 1939 over $700,000,000 of issues, including refunding, were privately placed, a practice not begun in 1929. The amount of new money included in the private issues, however, would not raise the total given in the table by any significant amount.

New Capital Security Offerings of Domestic Corporations, by Quarters, 1929-39
(In Millions of Dollars)

	1929*	1935	1936	1937	1938	1939
1st Qr.	$1,532	$ 20	$137	$390	$111	$ 82
2nd "	1,688	81	317	439	252	128
3rd "	1,518	130	315	246	342	91
4th "	1,050	173	422	150	167	69
Year	$5,788	$404	$1,192	$1,225	$872	$371

Source: Commercial and Financial Chronicle. (Refunding issues excluded.) *Investment trust issues excluded.

The depreciation reserves and undistributed earnings of business, plus the moderate amount of financing that has been done through banks and government agencies, add up to substantial totals available for capital expenditure. Nevertheless, business in the past has never been able to grow at a normal rate without access to the savings of the public through the new issue markets; and there is no evidence that it can resume its historic expansion merely by investing its own retained earnings. The causes of the decline in new issues are complex and controversial; they affect both the borrower and the lender; and they have been discussed frequently and at length. It is not our purpose to go over the ground again, but to point out that the essential expansion of new investment, needed to support business at the high levels of the past few months and to carry the upswing through to complete recovery, has not appeared. The trend of new capital issues will be one of the important influences upon the situation in the months ahead.

Recovery in 1939 Business Profits

Annual reports of leading corporations issued thus far show that the marked increase

in business volume last year was accompanied, in a majority of cases, by a sharp recovery of net profits from the depressed 1938 level. A preliminary tabulation of the reports of 370 leading manufacturing corporations, including those whose fiscal year closed prior to December 31, shows for 1939 combined net profits, less deficits, of approximately $329,000,000 after taxes, which is practically double the $159,000,000 reported by the same companies in 1938. To a considerable extent, the sharp gain in the total is due to the fact that numerous companies which had operated in the red during 1938 moved into the black last year. Net worth or shareholders' equity of this group aggregated $4,392,000,000 at the beginning of 1939, upon which the year's profits represented an average return of 7.5 per cent, against a return of 3.6 per cent upon a slightly higher net worth in 1938.

More comprehensive evidence as to the trend of business profits will become available during the next two months.

United States Exports and the War

At the outbreak of the war opinions differed as to the probable effects of the conflict upon the export trade of the United States. The extreme optimists, remembering the World War, jumped to the conclusion that our sales abroad would boom as in 1915, and for a time this seemed to be the dominant view. More thoughtful people, on the other hand, pointed out the reasons why purchases of the belligerents would not be concentrated in this country to the same extent as in the last war, and the difficulties in the way of great expansion of our sales to neutral countries. Some feared that temporarily our trade would diminish. They reasoned naturally that our sales to the blockaded area would almost disappear, and that normal purchases of other countries would be cut down by rationing of consumption and regulation of imports as well as by shipping and exchange difficulties.

Export figures for four months have now been published. How reliable a guide they may be to future trends remains to be seen, but they show that during that period, at any rate, our trade improved considerably. Disruptions due to the war have appeared, but on the whole the gains have exceeded the losses. The value of exports in December reached $357,000,000, the largest for any month since 1930. For the four months, September to December, 1939, the aggregate was $1,251,000,000, or 21 per cent more than in the same period of 1938.

This is in contrast to 1914, when during the first four months of the World War our exports fell below the 1913 level. Loss of the German market then affected us more seriously than now, since the Reich in 1913 took around 15 per cent of our exports compared with only 3 per cent in 1938.

The extent to which hopes of export gains in leading commodities have been realized is shown in the first part of the accompanying table. During the first eight months of 1939 our exports had run 7 per cent below the 1938 figure, but in the last four months they made the gain shown. Since exports vary seasonally, direct comparison of the Fall months with earlier months in 1939 is impracticable; but after normal allowance for seasonal factors December stands as the best month of the year.

Value of Principal U. S. Exports and Their Destinations

(In Millions of Dollars)

A) According to Leading Commodities & Classes	Jan.-Aug. 1938	Jan.-Aug. 1939	Sept.-Dec. 1938	Sept.-Dec. 1939	4 War Mo. % Change
Cotton, raw	140	86	89	157	+76
Tobacco, unmanufactured	70	52	86	25	—71
Grains & preparations	186	71	38	29	—24
Fruits & nuts	54	49	45	34	—24
Other agricultural products	78	85	42	68	+62
Total agricultural	528	343	300	313	+ 4
Machinery, total	336	333	150	169	+13
Metal-working machinery	67	76	35	41	+17
Elec. mach. & apparatus	68	67	34	38	+12
Automobiles, parts & acces.	185	178	85	76	—11
Aircraft, parts & acces.	49	70	19	47	+147
Iron & steel, mill products & manufactures	153	161	75	124	+65
Petroleum & related prod.	263	245	126	139	+10
Chemicals & related prod.	82	92	47	73	+55
Copper & related products	54	55	33	42	+27
Coal & coke	35	34	21	33	+57
Other non-agricul. products	339	361	177	236	+33
Total non-agricul. prod.	1,495	1,529	733	939	+28
GRAND TOTAL	2,023	1,872	1,034	1,251	+21
B) According to Leading Markets*					
United Kingdom	326	311	195	194	— 1
France	85	108	50	73	+46
Canada	323	284	145	207	+43
Other Dominions	107	95	55	53	— 4
Allied Powers	841	798	445	527	+18
German Territory**	108	67	57	1	—98
Holland, Belg., Switzer.	126	105	59	75	+27
Scandinavian Countries	79	86	45	77	+71
Italy	39	33	19	26	+37
Soviet Union	50	27	20	19	— 5
Area Bordering Germany	294	251	143	197	+38
Argentina	60	39	27	32	+19
Brazil	40	45	22	35	+59
Mexico	42	50	20	33	+65
Cuba	51	47	25	35	+40
Other Latin America	184	187	94	130	+38
Total Latin America	377	368	188	265	+41
Japan & China	207	193	106	127	+20

* Including re-exports. ** Includes Old Reich, Austria, former Czecho-Slovakia, Poland.

Sales of Farm Products Decline

The outstanding fact shown by the table is the decline, compared with a year earlier, in exports of certain staple agricultural products, and the increase in shipments of manufactured goods. The shift of our export trade from farm commodities and industrial raw materials over to factory products is of course an old story, and the war evidently will intensify the trend. Exports of farm products have suffered especially from trade and currency controls, from

the deliberate lowering of the standard of living in the totalitarian countries to finance armament, and now from rationing of consumers and from political and financial considerations connected with the war. The Allied Powers have been buying more extensively from their own Empires, whose productive capacity is vastly greater than at the start of the World War; likewise from the Balkan States and Turkey, in order to prevent the agricultural surpluses of these countries from going to Germany.

Hence, although shipments of certain foods to Scandinavian countries and Canada have increased, we have exported since the war started only a fraction of our 1938 exports of tobacco, and fresh fruit. The Department of Agriculture states that farm exports in the four months have been less than they would have been if war had not come, and believes this is likely to continue through much of 1940.

Cotton is the one important agricultural export which has increased. Cotton shipments during the first four war months gained 76 per cent in value and 64 per cent in volume over the same period in 1938. The war, however, is not the major cause of the gain, which was expected before the war started. The chief influences have been the subsidy paid on our exports, the need to replenish subnormal cotton stocks in Europe, and the sharp rise in Indian cotton prices which made American cotton relatively cheap. Only the latter can be ascribed to the war; and on the other side of the ledger is the loss of sales to Central European spinners, who have been taking 1,000,000 bales yearly, and a prospective general reduction of European cotton requirements.

Manufactured Goods and Metals

The significant gain in exports, therefore, is in manufactured products. The largest increase, as the table shows, took place in aircraft exports. Although declining during September and October, they surged upward after the passage of the Neutrality Act, and in December aggregated nearly $29,000,000, exceeding the exports of motor vehicles by $4,000,000. They will continue at very high figures. Another large gain was in the exports of iron and steel semi-manufactures and finished goods, with shipments to practically all countries increasing. Exports of metal-working machinery, which had already been stimulated by war preparations, expanded substantially after the outbreak. The same is true of the exports of petroleum products, industrial chemicals and motor trucks.

The stricter control of imports and foreign exchange has adversely affected our exports of luxury articles and passenger automobiles, ownership of which is being discouraged by high prices and rationing of gasoline in most of the European countries. On the other hand, automobile sales in the Latin American market except Argentina have been maintained.

In contrast with the World War, our exports of copper and other non-ferrous metals thus far have been stimulated but little. The reason, as in the case of agricultural products, is the greater self-sufficiency of the Allied Powers, resulting from the development of natural resources of their Empires during the past twenty-five years. Moreover, they are placing all the orders possible in areas where purchases will foster their own exports.

Changes in the Distribution of War Exports

The geographical distribution of our exports during the first four war months altered as generally anticipated. As may be seen from the second half of our table, sales to the German controlled territories, which in September-December 1938 amounted to $57,000,000, have practically vanished, but were more than offset by increased sales to countries bordering on those territories. A rise of over $60,000,000 or 43 per cent took place in our exports to Canada, which displaced Great Britain as our largest customer. Many of our exports to Canada were evidently for trans-shipment or for further processing, and in view of Canada's reduced imports from Europe, it seems that the war has increased the economic inter-dependence of this country and of the Dominion.

The Latin American countries, as had been expected, turned to us for a wide variety of articles which they could no longer get from the belligerent countries. Our sales during the four months were nearly $80,000,000 or 40 per cent larger than in the same period in 1938. Gains were distributed among all Latin American countries, with Mexico, Peru and Brazil contributing the largest share. As Germany sold in the full year 1938 about $250,000,000 worth of goods in Latin America, it is apparent that a substantial part of the former German business is coming to us.

The war is stimulating the industrialization of these countries. Their demand for certain of our industrial raw materials, such as coal, petroleum and steel semi-manufactures, and for industrial machinery, would probably have expanded even without the elimination of German competition.

The Prospect

Whether four months' figures supply a reliable indication of the export prospect for 1940 naturally is uncertain. The December total may have been enlarged by temporary factors, such as buying for inventory replenishment, similar to that which occurred in this country. Inquiries for consumers' goods are reported to have slackened.

The fundamental reasons remain why purchases of the belligerents will be widely dispersed rather than concentrated in this country, and will be held to the minimum every-

where, by curtailment of the standard of living. The neutrals have the problem of obtaining foreign exchange, which is difficult except as their own exports are stimulated. Since our increased sales to Latin America have been matched only in part by our larger imports and tourist expenditures, the problem of how the Latin American countries can find sufficient dollar resources to pay for more American goods persists. The difficulty in promoting balanced two-way trade, with certain of these countries whose exportable products are similar to our own, has been brought home by the failure of recent trade treaty negotiations with Argentina. If we are to hold the gains made in the Latin American market since the war started a way must be found to make the exchange of goods and services reciprocal.

Declarations of British officials and comment in the London economic press leave no doubt that Great Britain will spare no effort to maintain her own exports, as she must if she is to buy war materials. British exports were seriously disturbed after the outbreak of war, but by November order evidently was being restored; and exports of textiles, chemicals, coal, hardware, implements, etc., in that month were larger than in November, 1938. In other classifications they continued lower. In December total exports of British products made a further slight gain from November, and recovered completely to the 1938 level. Details for December, by commodity groups, are not yet available.

For all these reasons maintenance of the export gains made by the United States since September will not be an easy matter. On the other hand, mechanized warfare may, when or if it starts on a large scale, make Europe call upon us not only for airplanes, but for other war materials and manufactured goods on an enormous scale, as she did during the World War. It takes time for orders to be placed for this kind of goods, and for deliveries in volume to get under way. Also, the bloc of neutral countries is larger and economically more powerful than twenty-five years ago, and hence offers a wider scope for the expansion of our trade. Additions to our shipping services, in conjunction with other influences, afford hope of increased exports to British India and the East Indies.

In order to take advantage of the export opportunities opened by the war and to increase our sales of some products to an extent that will offset losses in others, adjustments in production in this country will be required. Obviously the growth of tobacco should be discouraged, but there is practically no limit to the market for any industry which can satisfactorily produce, for example, airplane equipment. Part of the problem presented by the war is to make these shifts in the industries.

Money and Banking

New high levels in reserves, in holdings of U. S. Government securities and in deposits were principal features of the banking statistics for the month.

Reflecting seasonal currency retirement, gains in gold and drafts by the Treasury upon its deposit balances in the Federal Reserve Banks, excess reserves of member banks rose by over half a billion dollars to $5,590,000,000 in the four weeks to January 24, surpassing the previous peak reached last October by approximately $60,000,000. While February should bring somewhat increased demands for currency, the prospect of continued gold purchases and of the further reduction of Treasury cash balances forecast in the budget message strongly suggests that the accumulation of surplus bank funds is not yet ended.

Investments by reporting member banks in government securities increased sharply in the first half of January to a new peak, owing chiefly to purchases of direct Treasury bonds by banks in New York City. Both for New York City and for the reporting banks as a group, holdings of this class of securities, as distinct from Treasury notes and bills, now stand at a higher level than at any time since separate figures became available last February.

Contrary to the trend in investments, loans of reporting banks declined in January, resulting in a lower level of total earning assets than in December. Deposits, on the other hand, expanded rapidly under the combined influence of the declining note circulation, inflowing gold and Treasury expenditures, and reached levels higher than ever before.

Bonds Hesitant

Despite the rise of bank excess reserves into new high ground and likelihood of further advances to come, the market for high grade bonds gave evidence in January of having lost some of its driving power. With prices of government bonds selling within a couple of points of their all-time highs, and some of the top-rated corporates establishing new peaks, investors apparently have become more cautious. As a result the market, following new highs for the recovery during the early part of the month, tended to drift lower, more however from lack of sustaining buying interest than from any significant selling pressure.

Corporate financing, both publicly and privately offered, aggregated about $165,000,000, of which $135,000,000 represented refinancing. While the volume of new capital asked for continues disappointingly small, the total of $30,000,000 in January was larger than in recent months.

Sterling Firmer

In foreign exchange, the free market rate for sterling, both spot and forward, improved in January with spot advancing to $4.00 for the

first time since early November. Official rates quoted by the Bank of England for foreign currencies were altered early in the month with a view to narrowing the "spread" between buying and selling rates—in the case of the dollar from $4.02-4.04 to $4.02½-4.03½.

Firmness in the sterling market, in which the recovery of British exports in December may have been one factor, has been accompanied by advances in British security prices, particularly those of gilt-edge issues. The latter have risen sharply in conjunction with the Treasury's conversion operation offering to holders of £350 millions of 4½ per cent bonds callable on July 1 either cash or new five-year 2 per cent notes at par. At a top price of just under 74 in January, the 2½ per cent Consols were up nearly 12 points from the pegged minimum established at the outbreak of war, and the highest in somewhat over a year.

Though not up to date, the figures published by the U. S. Treasury on international capital movements to the end of October are nevertheless of interest. As shown by the table below, British nationals in September and October sold on balance approximately $73,000,000 of American negotiable securities, or approximately 10 per cent of their holdings estimated by the Federal Reserve Board at about $735,000,000 at the outbreak of the war. The French holdings of American negotiable securities, put at $185,000,000 as of the end of August 1939, remained practically unchanged. The French, however, as well as the British, drew on their short-term bank balances here with the result that the capital position here of both was reduced by about $100,000,000 during the two months.

Net Capital Movement between U. S. and Foreign Countries in 1939

(In Millions of Dollars)

Plus sign denotes increase in foreign owned American securities and bank balances.

Minus sign denotes decrease in foreign owned American securities and bank balances.

	American Securities			Bank Balances			All Transactions*
	U.K.	France	All Countries	U.K.	France	All Countries	All Countries
Jan.	—22	—4	—29	— 13	+ 3	+ 64	+ 73
Feb.	+ 7	—1	+11	+ 39	+21	+119	+133
Mar.	—10	....	—12	+ 14	+ 4	+150	+149
Apr.	+ 6	+2	+31	+104	+59	+372	+389
May	— 6	+2	— 3	+ 28	....	+ 26	+ 47
June	— 7	—1	—10	+ 29	+ 9	+ 17	+ 25
July	— 7	—1	—17	— 16	+ 2	+ 35	+ 42
Aug.	— 1	—1	—17	— 9	+31	+264	+228
Sept.	—25	+1	— 1	+ 63	—20	+ 77	+ 93
Oct.	—48	....	—41	— 40	—38	— 64	— 97

*Includes also movement in brokerage balances and transactions in foreign securities.

Foreign currencies other than sterling were generally steady during January, excepting belgas and guilders, which were depressed by new rumors of German invasion of the Low Countries. On the 23rd the Dutch Premier proposed to Parliament a plan to revalue the gold holdings of the Netherlands Bank, amounting to over Fl. 1,000,000,000 (about $690,000,000) as of the end of December, the profit from the mark-up to be used to defray mobilization expenses and add to the resources of the equalization fund.

Gold Movements

Gold imports into the United States subsided somewhat in January, receipts during the first 17 days of around $140,000,000 comparing with $451,000,000 received in the full month of December. Nearly one-third of the imports came from Canada, which apparently is still transferring gold to the earmarked stocks of the Federal Reserve Banks. Some $37,000,000 of gold was received from Japan, and a small but steady stream continues to come from European neutral countries, notably Italy, the Netherlands, Norway and Sweden. Practically all the western European neutrals have been losing gold or foreign exchange since the war began. Following a loss of about Kr. 350,000,000 in foreign exchange and gold during the first four months of the war, the Swedish Government has ordered a compulsory declaration of private holdings of gold and foreign exchange and of all outstanding private debts and liabilities abroad.

As will be seen from the table below, total imports of gold for the full year 1939 reached $3,574,000,000, exceeding by far the previous record in 1938. At the end of the year the Treasury stock of gold aggregated $17,643,000,000 and counting also monetary silver in the Treasury and in circulation (valued at $1.29 per ounce) the combined metallic stock totaled $21,423,000,000. In contrast, gold reserves of all central banks and governments throughout the world were valued at approximately $4,857,000,000 at the end of 1913 and $10,306,000,000 at the end of 1929.

U. S. Monetary Reserves and Net Movement of Gold and Silver

(In Millions of Dollars)

	Monetary Reserves*			Net Imports	
	Gold	Silver**	Total	Gold	Silver†
1934............	8,238	1,280	9,518	1,132	86
1935............	10,125	1,970	12,095	1,739	336
1936............	11,258	2,402	13,660	1,117	171
1937............	12,760	2,807	15,567	1,586	80
1938............	14,512	3,347	17,859	1,974	223
1939............	17,643	3,780	21,423	3,574	71

*End of year. **All silver in the Treasury and in circulation valued at $1.29. †Valued at cost.

The President's Budget Message

The President's budget message to Congress, delivered January 4, falls naturally into two parts: first, the figures themselves, and, second, the President's discussion of them. The message relates to the current fiscal year, ending June 30 next, and also the following year, ending June 30, 1941. Inasmuch as the current year was half gone when the message was delivered, the original estimates for this year

are revised to that date, as a guide to deficiency appropriations, if necessary, and to actions on the estimates for the year beginning July 1 next. The President's discussion includes comments on revenues and expenditures, recommendations regarding taxation, and expressions of opinion and philosophy supporting the policies embodied in the budget.

The Budget Totals

Turning first to the over-all figures, for the current fiscal year the revised estimates place

Summary of the U. S. Budget as Presented by the President
Fiscal Years ended June 30, 1939-41
(In Millions of Dollars)

	Actual Fiscal Year 1939	Est. Fiscal Year 1940	Est. Fiscal Year 1941
RECEIPTS:			
Internal revenue	$5,161	$5,142	$5,650
Railroad Unemp. Ins. Act	—	5	7
Customs	319	283	273
Miscellaneous revenues	145	168	170
Total, revenues	$5,625	$5,598	$6,099
Realization upon assets	43	106	52
Total, receipts	$5,668	$5,704	$6,151
Deduct:			
Net appropriation for Federal old-age and survivors insurance trust fund	—	—	603
For purposes of comparison, net transfers to old-age reserve account (trust fund)	503	537	—
Net receipts	$5,165	$5,166	$5,548
EXPENDITURES:			
Legislative, judic., & exec.	$ 34	$ 35	$ 38
Civil departs. and agencies	916	994	952
Gen. Public Works Program	505	688	641
National defense	1,140	1,359	1,539
Vets'. pensions and benefits	550	550	561
Aids to agriculture	1,043	1,317	904
Aids to youth	368	380	308
Social security	347	378	437
Work relief	2,612	1,810	123
Refunds	68	69	71
Interest on the public debt	941	1,050	1,100
Transfers to trust accounts	182	209	225
Supplemental items:			
General	—	100	100
Relief	—	—	1,125
Subtotal	$8,707	$8,939	$8,124
Emergency national defense	—	160	300
Total expend. (excl. debt ret'm't)	$8,707	$9,099	$8,424
Excess of expenditures	$3,542	$3,933	$2,876
Less: Return of surplus funds from govt. corporations	—	—	700
NET DEFICIT	$3,542	$3,933	$2,176
DEBT RETIREMENT	58	100	100
GROSS DEFICIT	$3,601	$4,033	$2,276
MEANS OF FINANCING DEFICIT:			
New taxes	—	—	$ 460
Net decrease in working bal.	$ 262	$1,150	—
Borrowings	—	—	—
Replacing debt retirement	58	100	100
Increasing the public debt	3,280	2,783	1,716
Total, means of financing	$3,601	$4,033	$2,276

Note: Recent amendments to the Social Security Act created the "Federal old-age and survivors insurance trust fund" to which was transferred, on Jan. 1, 1940, the balance to the credit of the Old-age reserve account. For 1941 and subsequent years an amount equivalent to 100 per cent of the taxes received under the Federal Insurance Contributions Act, less administrative expenses, is appropriated directly to the trust fund. In order to show comparable expenditure figures for the three years in the above Summary, net expenditures under the Old-age reserve account of $537,355,000 in 1940 and $503,000,000 in 1939 have been eliminated. These items, which represented transfers to the trust account, are still included in the trust account statements.

expenditures (excluding sinking fund) at $9,099,000,000, an increase of $392,000,000 over last year. With "net receipts" estimated at $5,166,000,000, or about the same as last year, the net deficit apparently will rise by nearly $400,000,000 to almost $4,000,000,000. This is the largest total "in the red" for any year since the Great War, excepting only 1936 the year of the soldiers' bonus.

For 1941 a somewhat more hopeful picture is presented. Thus, expenditures (excluding sinking fund) budgeted at $8,424,000,000 are expected to be $675,000,000 less than in the current year, while "net receipts" estimated at $5,548,000,000 are expected to be $382,000,000 higher, an aggregate gain (if realized) of $1,057,000,000. The President then refers to the several "credit corporations" in which the Treasury has made investments for the purpose of effectuating its policies and says that "with lessening need for loans in some cases and growing surpluses in other cases, it appears that some of those corporations will have excess capital funds," and he estimates that $700,000,000 may be returned to the Treasury. The three items aggregate $1,757,000,000 and this sum deducted from the deficit figures for 1940 would leave $2,176,000,000, which is his estimate for next year's deficit. However, he recommends that additional taxes be imposed to cover the emergency national defence expenditures in the fiscal years 1940-41, estimated at $460,000,000. Deducting this sum from the $2,176,000,000 leaves $1,716,000,000, which he accepts as the final deficit, if the new taxes are imposed.

Principal Increases and Decreases in 1941

Examining the budget for 1941 in further detail, it will be seen that the President expects to effect savings in 1941 mainly in the following particulars:

Work relief	—562	millions
Aids to agriculture	—413	"
Aids to youth	— 72	"
General public works	— 46	"
Civil departments and agencies	— 41	"
	—$1,134	millions

Against these savings, however, are the following important added costs:

National defense	+320	millions
Interest on public debt	+ 50	"
Social security	+ 58	"
	+$428	millions

Balancing the foregoing figures, and allowing for other smaller increases and decreases, gives the net reduction of $675,000,000 in overall cost mentioned above.

With the anticipated increase in national defense outlays, total expenditures under this heading are expected to reach $1,840,000,000 in 1941, more than doubling in four years and more than trebling since the post-war low in 1934. Anticipated expenditures for work relief,

despite the budgeted reduction, still foot up to the formidable sum of $1,300,000,000, notwithstanding the expected improvement in business indicated by the revenue estimate. Counting also "aids to agriculture" and "aids to youth" it is interesting to note that proposed expenditures in these three "aid" groups exceed $2,400,000,000. Moreover, these figures do not include expenditures under the general public works program, or the pension, retirement and related assistance programs financed with federal funds, which in 1941 amount to $1,200,000,000.

To avoid carrying the federal direct debt above the statutory limit of $45,000,000,000, the President proposes to supplement borrowing by a reduction of $1,150,000,000 in the Treasury's working cash balances during 1940 (of which $560,000,000 was made through January 25) and by $460,000,000 of new taxes in 1941. On this basis, if the Government keeps within the budgeted expenditures, if revenues hold up to expectations and if Congress enacts the new taxes, the direct federal debt on June 30, 1941, will fall short of the statutory debt limit by the slender margin of about $60,000,000. This, however, does not include the contingent debt on fully guaranteed obligations issued by government agencies, amounting to $5,737,000,000 on November 30, 1939.

What Do the Figures Mean?

So much for the bare figures. What do they mean in terms of progress toward a balanced budget and a sound fiscal position for the country?

In the first place, it should be stated that the indicated reduction in the deficit for 1941 is to be welcomed, even though it signifies little reduction in total expenditures, and plainly is influenced by the debt limit.

In considering the indicated reduction in total expenditures next year, it is important to note that a material change was made in the form of budget presentation this year by deducting social security taxes from total revenue receipts, and deducting social security investments in the reserve account from total expenditures. If these items are included, so as to make the figures comparable with those of prior years and to show the over-all totals, expenditures in each of the three fiscal years 1939-40-41 will be found to be in excess of $9 billions and higher than in any other peacetime year, not excepting the bonus year 1936.

It is important to note also that the two proposals toward financing the deficit—drawing down the cash balance by $1,150,000,000 and withdrawing $700,000,000 from the capital of government agencies—are both non-recurring sources of funds and do not represent income but rather an expenditure of assets on hand. Moreover, when the budget for the 1941 fiscal year was presented, it was pointed out that certain of the major items, including relief, were only tentative and that additional appropriations might be necessary during the period. In a number of recent years the experience has been that the final total of expenditures has exceeded the original or revised budgets by as much as $1,000,000,000 or even more.

Eliminating the non-recurring sources of funds just mentioned, it will be seen that on the basis of estimated expenditures for 1940 and 1941 the debt increase for the two years alone would amount to approximately $6,800,000,000, exceeding the present statutory limit by $2,200,000,000. How long can this continue? In his budget message the President has called for $460,000,000 of new taxes in 1941, but as analysis of the figures has shown even this will fail to produce any lasting equilibrium if the current rate of spending goes on unchecked.

The Rising Cost of Government

It is to be considered that never in the history of the country—not even in the biggest booms or under the influence of war-time excess profits tax—have the revenues of the Government come within $2 billions of the more than $9 billions of estimated average expenditures for 1939-40-41. The budgeted tax receipts for 1941, including social security taxes, amounting to $6,151,000,000, are the largest ever collected in this country except in

Condensed Summary of United States Government Finances, 1914-1941

(In Millions of Dollars)

Year Ended June 30	Total Government Receipts	Total Govt. Expenditures*	Surplus or Deficit*	Gross Debt (a) June 30
1914	$735	$ 735	$—	$ 1,188
1915	698	761	— 63	1,191
1916	783	734	+ 48	1,225
1917	1,124	1,978	— 853	2,976
1918	3,665	12,697	— 9,032	12,244
1919	5,152	18,515	—13,363	25,482
1920	6,695	6,403	+ 292	24,298
1921	5,625	5,116	+ 509	23,976
1922	4,109	3,373	+ 736	22,964
1923	4,007	3,295	+ 712	22,350
1924	4,012	3,049	+ 963	21,251
1925	3,780	3,063	+ 717	20,516
1926	3,963	3,098	+ 865	19,643
1927	4,129	2,974	+ 1,155	18,510
1928	4,042	3,103	+ 939	17,604
1929	4,033	3,299	+ 734	16,931
1930	4,178	3,440	+ 738	16,185
1931	3,190	3,671	— 481	16,801
1932	2,006	4,535	— 2,529	19,487
1933	2,080	3,864	— 1,784	22,539
1934	3,116	6,011	— 2,895	27,053
1935	3,800	7,010	— 3,210	28,701
1936	4,116	8,666	— 4,550	33,778
1937	5,294	8,442	— 3,148	36,425
1938	6,242	7,626	— 1,384	37,165
1939	5,668	9,210	— 3,542	40,440
1940 (b)	5,704	9,636	— 3,933	43,222
1941 (bc)	6,851	9,027	— 2,176	44,939

Source: Compiled from President's Budget Messages and annual reports of the Secretary of the Treasury. * Excludes expenditures for debt retirement through sinking fund. (a) Direct debt only; does not include guaranteed debt of government agencies. (b) Budget estimate; includes social security tax receipts and appropriations for old-age reserve. (c) Includes return of surplus funds from government corporations.

1920 and 1938. Total receipts from all sources in 1941, including $700,000,000 return of capital from government corporations, are estimated to reach a new high total for all time, as indicated by the preceding summary.

Moreover, the sum-total of state, county, municipal and other local taxes has increased greatly during recent years and now amounts to approximately $8 billions. Thus the total tax burden now exceeds $14 billions, which is 22 per cent of the entire estimated national income. Total taxes in 1938 represented $105 annually per capita of population, or $420 for the average family of four, and were practically as high as in Great Britain, notwithstanding the huge British War debt. And still the balancing of the federal budget is not in sight, and new burdens upon the taxpayer are being proposed not only by the Federal Government but also by many of the states and smaller sub-divisions.

To many not familiar with the figures, it may come as a surprise that $9 billions of federal expenditures annually is higher than the entire annual net income for these years of all corporations in the United States. Treasury statistics for 1937, which are the latest available and cover a relatively good year, show that the 477,838 active corporations in this country had a combined net income, before payment of federal income and excess profits taxes, and not including intercorporate dividends (which do not represent real income for the corporate system as a whole) of but $5,148,000,000.

Similarly, a comparison of individual income statistics and budget expenditures reveals that if all individual incomes in the United States over $5,000 were taken in their entirety, the grand total would still fall considerably short of meeting the federal expenditures alone. Official figures for 1937 show that incomes of over $5,000 were reported by 705,033 persons or family groups, having a combined net income of $8,816,000,000 before federal income taxes, of which the portion over $5,000 would be $5,291,000,000.

Efforts to devise additional taxes only expose in clearer light the multitude of revenue sources that have been tapped and drained heavily since 1914 and their potentialities for additional revenue substantially reduced. It is a matter of grave doubt whether taxes on corporations can be further increased without reducing production and employment. As to individual incomes, it is well known that taxes on large incomes have already reached confiscatory levels and are diverting capital from investment in industry to tax-exempt municipal bonds. People in the middle income brackets, where new taxes seem most likely to fall, view with dismay the constant encroachments of the tax collector, which instead of resulting in the hoped-for progress towards a balanced budget and an end to the ominously mounting public debt seem merely to encourage new and more ambitious schemes for spending.

No more striking illustration can be had of the growth and expansion of governmental costs than a comparison of the present budget with the following simple table of federal expenditures in 1914:

Legislative, judicial and civil	$226	millions
National defense	313	"
Veterans' pensions and benefits	173	"
Interest on public debt	23	"
Total	$735	"

At that time the sum total of governmental costs, amounting to but $735,000,000, was confined to the civil, legislative and judicial departments, national defense, and to war pensions and public debt interest. Not only have the expenditures in these four categories more than trebled, but they now represent only a third of the whole budget, which has multiplied twelve-fold.

Obstacles to Economy

That the trend exhibited by the foregoing figures cannot be continued indefinitely is generally conceded. In spite of this there are two principal reasons why the accomplishment of genuine economy in government remains in doubt. One of these reasons is the continued reliance by the Administration upon the policy of spending to promote recovery.

In his budget message, the President reiterates his faith in "the deliberate use of government funds and of government credit to energize private enterprise—to put purchasing power in the hands of those who urgently need it and to create a demand for the products of factory and farm." It was this policy, he contends, that brought about the rise in the national income from 1933 to 1937, and was responsible in 1938 for halting the downturn then in progress so that "in place of the $42,000,000,000 decline in national income that occurred from 1929 to 1932, the decline from 1937 to 1938 scarcely exceeded $8,000,000,000," and was followed by quick recovery.

These, however, are highly controversial claims, the merits and demerits of which have been discussed repeatedly in these columns. Suffice it to say at this point that certain facts stand out as indisputable, to wit:

First, there is nothing in the longer history of the country to prove, and much to disprove, the theory that government spending is necessary to recovery, and,

Second, despite all the billions of federal money spent since 1933 to "prime the pump," there remain 8,000,000 unemployed, national income is still much below the level of 1929, while direct public debt has been increased to a point $25,000,000,000 higher than in that year, and is still rising. It is indeed discouraging to

learn from the President's message that not even yet, after so much spending and increase of debt, is the level of employment and national income regarded as sufficiently secure to warrant suspension of deficit financing.

In view of the failure of the spending policy to date, the continued acceptance by the Government of the spending philosophy must seriously affect the probability that any material reduction in governmental costs is yet in sight.

The second reason why economy in government remains in doubt lies in the constant demands upon the Treasury from different pressure groups for subsidies, pensions and other forms of handouts. Unless these demands are met by an enlightened and aggressive public opposition, it will be difficult for Congress to resist them. We cannot expect government costs to come down and at the same time look to the government to provide all sorts of new benefits and services that cost money. In other words, economy in government is not just a responsibility of the elected representatives of the people in Washington and in the various state and local capitals; it is also a responsibility of the people themselves. Only as they are willing to exercise forbearance and to give their support to those who have the courage to cut costs can any substantial progress be made.

The Problem of Low Incomes

In the January issue of this Letter reference was made, under title of "The Problem of Unemployment," to certain extracts from an address by Dr. Lena M. Phillips, president of the International Federation of Business and Professional Women—among them the following:

> Women's faith is unsettled by the fact that, while millions were in dire poverty or upon relief, in 1934 America's productive capacity of goods and services was only about 55 per cent used. It is against their social conscience, and, for many, their Christian faith, that in the world's richest country, where there is more than a proportionate share of almost everything, 19,000,000 workers in the peak year of 1929 each received for his labor less than $1,000, although as adequately proven a man could not at that time support his family decently for less than $1,800 per year.

Since this article appeared, one of our readers has called our attention to a fallacy in Dr. Phillips' statement which had been overlooked in our comment. Because interest in the subject of income distribution is widespread, and the information circulating is often misleading, further reference to Dr. Phillips' statement seems in order.

As to the point about the "19,000,000 workers in the peak year of 1929, etc.," the implication is that each of these workers was responsible for the support of a family, which it appears safe to say was not in accordance with the facts. As our correspondent indicates, census reports show that there were in 1930, the nearest census year, approximately 48,800,000 persons "gainfully occupied" in the United States. Inasmuch as census reports also show approximately 29,900,000 families, averaging about 4 persons each, in the same year, the conclusion seems warranted that there were "gainfully occupied" on the average more than one and one-half persons per family. On this basis the average income per family would be substantially above the $1,000 implied by Dr. Phillips.

What the nature and source are of the "adequate proof" that no family could live "decently" on less than $1,800 per year, is not indicated. We venture to say, however, that the statement would come as a surprise to a great many families throughout the country who are managing to live comfortably on considerably less than that amount of cash income per year. Obviously a great deal depends upon the locality in which people live—whether in the large cities, or in the smaller towns and villages or on farms—and also the extent to which people are able to supplement cash income in other ways, as, for example, by home-produced food or by exchange of services not involving cash payments. According to a study by the United States Bureau of Labor Statistics of automobile ownership, the average percentage of white families in middle-sized cities having incomes of $1,500 to $1,750 per year and owning automobiles ranged from 61.1 per cent in the East Central States to 87.8 per cent in the Pacific Northwest.

That incomes are distressingly low in far too many cases is of course true. Everyone wants to see the average level of incomes raised, but this can be done only by raising total production and income so that there will be more to be divided. It cannot be done by dividing up the existing income, for that would not raise the average, but on the contrary would decrease it, as production would collapse. It is indicative of the confused state of public thinking that at the very time when people like Dr. Phillips are complaining that a large part of our population lacks even the decencies of life, others are asserting that the growth of the country is "through" and that there is no more work to be done beyond repairing and replacing what we have.

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